

# CRS Report for Congress

## International Trade: Rules of Origin

Updated August 22, 2008

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Prepared for Members and  
Committees of Congress

| <b>Report Documentation Page</b>  |                                    |   | Form Approved<br>OMB No. 0704-0188                        |                                  |
|---|------------------------------------|---|---|----------------------------------|
| <p>Public reporting burden for the collection of information is estimated to average 1 hour per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden, to Washington Headquarters Services, Directorate for Information Operations and Reports, 1215 Jefferson Davis Highway, Suite 1204, Arlington VA 22202-4302. Respondents should be aware that notwithstanding any other provision of law, no person shall be subject to a penalty for failing to comply with a collection of information if it does not display a currently valid OMB control number.</p> |                                    |   |   |                                  |
| 1. REPORT DATE<br><b>22 AUG 2008</b>  | 2. REPORT TYPE                     | 3. DATES COVERED<br><b>00-00-2008 to 00-00-2008</b> |   |                                  |
| 4. TITLE AND SUBTITLE<br><b>International Trade: Rules of Origin</b>  |                                    | 5a. CONTRACT NUMBER                                 |   |                                  |
|   |                                    | 5b. GRANT NUMBER                                    |   |                                  |
|   |                                    | 5c. PROGRAM ELEMENT NUMBER                          |   |                                  |
| 6. AUTHOR(S)  |                                    | 5d. PROJECT NUMBER                                  |   |                                  |
|   |                                    | 5e. TASK NUMBER                                     |   |                                  |
|   |                                    | 5f. WORK UNIT NUMBER                                |   |                                  |
| 7. PERFORMING ORGANIZATION NAME(S) AND ADDRESS(ES)<br><b>Congressional Research Service,The Library of Congress ,101 Independence Ave, SE,Washington,DC,20540-7500</b>  |                                    | 8. PERFORMING ORGANIZATION REPORT NUMBER            |   |                                  |
| 9. SPONSORING/MONITORING AGENCY NAME(S) AND ADDRESS(ES)   |                                    | 10. SPONSOR/MONITOR'S ACRONYM(S)                    |   |                                  |
|   |                                    | 11. SPONSOR/MONITOR'S REPORT NUMBER(S)              |   |                                  |
| 12. DISTRIBUTION/AVAILABILITY STATEMENT<br><b>Approved for public release; distribution unlimited</b>   |                                    |   |   |                                  |
| 13. SUPPLEMENTARY NOTES   |                                    |   |   |                                  |
| 14. ABSTRACT  |                                    |   |   |                                  |
| 15. SUBJECT TERMS   |                                    |   |   |                                  |
| 16. SECURITY CLASSIFICATION OF:   |                                    |   | 17. LIMITATION OF ABSTRACT<br><b>Same as Report (SAR)</b> | 18. NUMBER OF PAGES<br><b>23</b> |
| a. REPORT<br><b>unclassified</b>  | b. ABSTRACT<br><b>unclassified</b> | c. THIS PAGE<br><b>unclassified</b>                 | 19a. NAME OF RESPONSIBLE PERSON                           |                                  |

# International Trade: Rules of Origin

## Summary

Determining the country of origin of a product is important for properly assessing tariffs, enforcing trade remedies (such as antidumping and countervailing duties) or quantitative restrictions (tariff quotas), and statistical purposes. Other commercial trade policies are also linked with origin determinations, such as country of origin labeling and government procurement regulations.

Rules of origin (ROO) can be very simple, noncontroversial tools of international trade as long as all of the parts of a product are manufactured and assembled primarily in one country. However, when a finished product's component parts originate in many countries — as is often the case in today's global trading environment — determining origin can be a very complex, sometimes subjective, and time-consuming process.

U.S. Customs and Border Protection (CBP) is the agency responsible for determining country of origin using various ROO schemes. *Non-preferential* rules of origin are used to determine the origin of goods imported from countries with which the United States has most-favored-nation (MFN) status. *Preferential rules* are used to determine the eligibility of imported goods from certain U.S. free trade agreement (FTA) partners and certain developing country beneficiaries to receive duty-free or reduced tariff benefits under bilateral or regional FTAs and trade preference programs. Preferential rules of origin are generally specific to each FTA, or preference, meaning that they vary from agreement to agreement and preference to preference.

On July 25, 2008, CBP proposed implementing a more uniform system of ROO as an alternative to the “substantial transformation” rule that currently in place. CBP says that this system “has proven to be more objective and transparent and provide greater predictability in determining the country of origin of imported merchandise than the system of case-by-case adjudication they would replace.” The scheme that would be applied has already been used for several years to determine the origin of imports under the North American Free Trade Agreement (NAFTA), and for most textile and apparel imports (about 40 percent of U.S. imports). The proposal would apply to all country of origin determinations made by CBP, unless otherwise specified (e.g., unless the import enters under a preferential ROO scheme already in place).

This report deals with ROO in three parts. First, we describe in more detail the reasons that country of origin rules are important and briefly describe U.S. laws and methods that provide direction in making these determinations. Second, we discuss briefly some of the more controversial issues involving rules of origin, including the apparently subjective nature of some CBP origin determinations, and the effects of the global manufacturing process on ROO. Third, we conclude with some alternatives and options that Congress could consider that might assist in simplifying the process. This report will be updated as events warrant.

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# International Trade: Rules of Origin

## Introduction

Recent trade policy issues have pointed to the framework used by the United States and other countries to regulate imports, including the process of determining country of origin using “rules of origin” (ROO). Such rules can be very simple, noncontroversial tools of international trade as long as all of the parts of a product are manufactured and assembled primarily in one country.<sup>1</sup> However, when a finished product’s component parts originate in many countries — as is often the case in today’s global trading environment — determining origin can be a very complex, sometimes subjective, and time-consuming process.

The determination of a product’s country of origin can also have significant implications for an imported product’s treatment with respect to a number of different U.S. trade programs and government policies. For example, the United States currently has restrictions on the import of products from certain countries (including Burma, Cuba, and North Korea) as part of larger foreign policy considerations. The U.S. government also seeks to promote the growth of imports from developing nations via the Generalized System of Preferences (GSP), and other programs in an effort to foster economic growth and prosperity in those nations. These policies, and many others, rely on country of origin determination in order to fulfill their stated goals and objectives and, in turn, the determination of country of origin relies on U.S. implementation of rules of origin.

Certain key characteristics of contemporary globalized manufacturing may also prove challenging to the ROO process and its implementation procedures. These key characteristics include multinational manufacturing; the subcontracting of manufacturing; and highly-competitive manufacturing. Some observers mention that the combined effects of these three characteristics have created a globalized manufacturing environment that is sufficiently intricate and flexible to make the application of ROO more complex, potentially misleading, or both. In addition, businesses operating in the current globalized manufacturing environment are increasingly able to respond to changes in U.S. trade policies by manipulating their supply chains in ways that are able to circumvent the intended goals and objectives of those policies.

This report first provides a general overview of the U.S. ROO system, including its implementation as it applies to manufactured imports. Second, advantages and disadvantages of the ROO schemes as implemented by the United States are also discussed. Third, the report illustrates ways in which the application of the rules of

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<sup>1</sup> LaNassa, Joseph A. “Rules of Origin and the Uruguay Round’s Effectiveness in Harmonizing and Regulating Them,” *The American Journal of International Law*, 90:4 (October 1996), pp. 625-640.

origin system can lead to country of origin determinations that could be inconsistent with U.S. policy objectives or goals, or encourage businesses to circumvent them. The report concludes with some options that Congress could consider in order to improve the ROO process.

## Rules of Origin in U.S. Practice

The country of origin of an imported product is defined in U.S. law and Customs regulations as the country of manufacture, production, or growth of any article of foreign origin entering customs territory of the United States.<sup>2</sup> *Non-preferential* rules of origin are used to determine the origin of goods imported from countries with which the United States has most-favored-nation (MFN) status, and are the principal regulatory tools for accurate assessment of tariffs on imports, addressing country of origin labeling issues, qualifying goods for government procurement, and enforcing trade remedy actions and trade sanctions. *Preferential* rules of origin are used to determine the eligibility of imported goods from certain U.S. free trade agreement (FTA) partners and certain developing country beneficiaries to receive duty-free or reduced tariff benefits under bilateral or regional FTAs, trade preference programs (such as the Generalized System of Preferences), and other special import programs. Preferential ROO schemes vary from agreement to agreement and preference to preference.

There is no specific U.S. statute that provides an overall definition of “rules of origin” or “country of origin.” Instead, U.S. Customs and Border Protection (CBP) — the agency primarily responsible for determining country of origin (as it is for enforcing the tariff, customs, and other laws that apply to imported products) — relies on a body of court decisions, CBP regulations, and agency interpretations to confer origin on an imported product if the matter is in doubt.<sup>3</sup>

Although CBP is tasked with enforcing U.S. trade laws, the Customs Modernization Act (Title VI of P.L. 103-182) actually shifted much of the responsibility for complying with customs laws and regulations from CBP to the importer of record.<sup>4</sup> This means that the importer must understand customs procedures (including, for example, the applicability of a preferential ROO scheme to his or her product and country of origin), and apply “reasonable care” to enter, properly classify, and determine the value of merchandise so that CBP can properly assess duties, collect accurate statistics, and determine whether all other applicable

<sup>2</sup> 19 C.F.R. § 134.1. The customs territory of the United States is defined in General Note 2 of the Harmonized Tariff Schedule as the 50 states, the District of Columbia, and Puerto Rico.

<sup>3</sup> Most CBP rulings from 1989 to the present are available in a searchable database known as the Customs Rulings Online Search System (CROSS), at [http://rulings.cbp.gov/].

<sup>4</sup> Title VI of the North American Free Trade Agreement Implementation Act, P.L. 103-182. Also known as the “Mod Act.” For example, see 19 U.S.C. § 1508, as amended.

legal requirements have been met.<sup>5</sup> In cases where the country of origin is unclear, importers may seek advance ROO rulings from CBP in an effort to accelerate the import process.

## Non-Preferential Rules of Origin

Imports from countries that the United States has granted MFN status receive more favorable tariff treatment than imports from countries that do not receive this status.<sup>6</sup> Non-preferential ROO ensure that imports from U.S. trading partners receive the proper tariff treatment. Non-preferential ROO are also important for country of origin labeling, government procurement, and enforcement of trade remedy actions, compilation of trade statistics, supply-chain security issues, and other laws.<sup>7</sup>

Under non-preferential rules, two major principles apply. First, goods that are wholly the growth, product, or manufacture of one particular country are attributed to that country. This is known as the *wholly obtained* criterion.

Second, if an imported product consists of components that are from more than one country, a criterion known as *substantial transformation* is used to confer origin. In most cases, the origin of the good is determined to be *the last place in which it was substantially transformed into a new and distinct article of commerce*<sup>8</sup> based on a change in name, character, or use. Making the determination about what constitutes a change sufficient for a product to be considered *substantially transformed* is the juncture at which an origin ruling can prove to be quite complex. When determining origin, CBP takes into account one or more of the following factors:

- the character/name/use of the article;
- the nature of the article's manufacturing process, as compared to the processes used to make the imported parts, components, or other materials used to make the product;
- the value added by the manufacturing process (as well as the cost of production, the amount of capital investment, or labor required) compared to the value imparted by other component parts; and

<sup>5</sup> U.S. Customs and Border Protection, *What Every Member of the Trade Community Should Know about Recordkeeping*, Informed Compliance Series, January 2005. See also, U.S. Customs and Border Protection, *What Every Member of the Trade Community Should Know about Reasonable Care*, Informed Compliance Series, February 2004.

<sup>6</sup> As a member of the World Trade Organization (WTO), the United States must grant immediate and unconditional most-favored-nation (MFN) treatment to the products of other Members with respect to tariffs and other trade-related measures. The only two countries not currently afforded MFN status are Cuba and North Korea.

<sup>7</sup> United States International Trade Commission, *Country of Origin Marking: Review of Laws, Regulations, and Practices*, USITC Publication 2975, July 1996, pp. 2-4 (hereinafter COO Marking Report).

<sup>8</sup> The substantial transformation standard was first applied by the U.S. Supreme Court in *Anheuser-Busch Brewing Association v. United States*, 207 U.S. 556. See also U.S. Customs and Border Protection, *What Every Member of the Trade Community Should Know about U.S. Rules of Origin*, Informed Compliance Series, May 2004, p. 9.

- whether the essential character is established by the manufacturing process or by the essential character of the imported parts or materials.<sup>9</sup>

Origin determinations are very fact-specific, but as CBP itself has acknowledged, there can still be considerable uncertainty about what is deemed to be substantial transformation due to the “inherently subjective nature” which may be involved in CBP interpretations of these facts.<sup>10</sup>

**International Agreements on ROO.** Participating countries in the Uruguay Round of multilateral trade talks recognized the need for rules of origin to be objective, understandable, predictable, and transparent. In the Agreement on Rules of Origin, World Trade Organization (WTO) members agreed not to use rules of origin to pursue trade policy objectives in a manner that would disrupt trade, and to apply them in a consistent, uniform, impartial and reasonable manner.<sup>11</sup> WTO members also agreed to notify other members about preferential ROO, including a listing of the preferential arrangements which they implement, along with all applicable administrative decisions and rulings.<sup>12</sup>

**Non-Preferential Harmonization Program.** The Agreement established a three-year (beginning in 1996) Harmonization Work Program (HWP) in an effort to develop uniform, cooperative, and coherent non-preferential rules of origin to be used by all WTO members.<sup>13</sup> Ongoing negotiations are carried out by the WTO Committee on Rules of Origin (CRO) under the WTO Council for Trade in Goods, and the World Customs Organization (WCO) Technical Committee on Rules of Origin (TCRO).<sup>14</sup> A first draft of a consolidated text was issued in 1998, and a technical review was completed in 1999. These efforts have secured agreement on an overall design for harmonized rules of origin, including definitions, general rules, and two appendices (one on definitions of wholly obtained goods and one on product-specific rules of origin).<sup>15</sup>

<sup>9</sup> COO Marking Report, pp. 2-5.

<sup>10</sup> The U.S. Customs Service proposed setting uniform rules of origin for imports beginning in 1991 (56 F.R. 48448), and again in 1994 (59 F.R. 141). See also, U.S. House of Representatives, Committee on Ways and Means, Subcommittee on Trade. *Rules of Origin*. Hearing. 104<sup>th</sup> Congress, 1<sup>st</sup> Session, July 11, 1995. Serial 104-27. A similar proposal was introduced on July 25, 2008 (73 F.R. 43385).

<sup>11</sup> World Trade Organization, Agreement on Rules of Origin, Part II, Article 2, “Disciplines During the Transition Period.”

<sup>12</sup> Ibid., Annex II (4).

<sup>13</sup> Ibid., Part IV, Article 9.

<sup>14</sup> World Customs Organization home page, at [<http://www.wcoomd.org/>].

<sup>15</sup> Ibid.

In the Trade Act of 2002 (P.L. 107-210), one of the principal negotiating objectives set forth was the conclusion of an agreement on rules of origin.<sup>16</sup> According to the United States Trade Representative (USTR), reaching agreements on the technical aspects of the HWP have turned out to be more complex than initially envisioned, and negotiations are expected to continue through 2008.<sup>17</sup>

## Preferential Rules of Origin

Preferential rules of origin are used to verify that products are eligible for duty-free status under U.S. trade preference programs such as the Generalized System of Preferences (GSP), the African Growth and Opportunity Act (AGOA), or free trade agreements (FTAs), such as the North American Free Trade Agreement (NAFTA).<sup>18</sup>

As with non-preferential ROO, if goods are “wholly the product” of a beneficiary of preference program or FTA, establishing origin is usually fairly straightforward. However, if a good was not entirely grown or manufactured in the targeted country/region, specific rules of origin may apply. These ROO can be very detailed and specific, and vary from agreement to agreement and preference to preference.

For example, in some agreements, a *tariff shift* method, or change in tariff classification (as a result of production occurring entirely in one or more of the parties), may be used to determine whether or not the product qualifies for these benefits. The NAFTA is one example in which this methodology is used.<sup>19</sup> With certain products, a *technical* test may be used, meaning that specific processing operations must occur in the originating country.<sup>20</sup>

<sup>16</sup> P.L. 107-210, sec. 2102 (13).

<sup>17</sup> Ibid.; U.S. Trade Representative. *2008 Trade Policy Agenda and 2007 Annual Report of the President of the United States on the Trade Agreements Program*, March 2008, p. 41 (hereinafter USTR Trade Policy Agenda).

<sup>18</sup> Application of preferential ROO includes the following U.S. preference programs and agreements: African Growth and Opportunity Act (AGOA); the Andean Trade Preference Act (ATPA); the Andean Trade Promotion and Drug Eradication Act (ATPDEA); the Automotive Products Trade Act; the Caribbean Basin Economic Recovery Act (CBERA); the Compact of Free Association Act (FAS); the Generalized System of Preferences (GSP); the Haitian Hemispheric Opportunity through Partnership Encouragement (HOPE) Act of 2006 (an amendment to CBERA); Insular Possessions of the United States; the North American Free Trade Agreement (NAFTA); products of the West Bank, the Gaza Strip, and associated Qualifying Industrial Zones; the United States-Caribbean Basin Trade Partnership Act (CBTPA); the Dominican Republic-Central America-United States Free Trade Agreement (CAFTA-DR); and United States bilateral FTAs with Israel, Jordan, Chile, Singapore, Australia, Morocco, and Bahrain.

<sup>19</sup> 19 C.F.R. § 102. These rules are also known as the “NAFTA marking rules” and apply only to Canada and Mexico, except for 19 C.F.R. 102.21 which applies to rules of origin for textiles and apparel from all countries except Israel (rules for Israel are set forth in 19 C.F.R. 102.22).

<sup>20</sup> Hirsch, Moishe “International Trade Law, Political Economy and Rules of Origin — A (continued...)

For most FTAs and preference programs, a *local content* test, requiring that a product contain a minimum percentage of domestic value-added (component or manufacturing process) in the originating country is required in order to confer origin and thus receive the tariff benefit.<sup>21</sup> The amount of local content required may vary among the different trade arrangements, and from product category to product category within an arrangement. In some cases, the local content requirement may be fulfilled on a regional basis. For example, in order to qualify for duty-free treatment under the Generalized System of Preferences, (1) the cost or value of the materials produced in that developing country (or produced *in one or more members of an association of countries treated as one country under GSP*), and (2) the direct cost of processing operations performed in that beneficiary country (or association of countries as described above), is *at least 35 percent of the appraised value of the product.*<sup>22</sup>

## Pros and Cons of U.S. Rules of Origin Methodology

Due to their obscure and technical nature, rules of origin schemes are generally not in the forefront of the continuing debates on trade liberalization or globalization. Nevertheless, the role of ROO schemes (both preferential and non-preferential) is central to the international trading system and trade negotiations. In order for goods to receive the benefits of trade agreements which the United States has entered into, or trade preferences that the United States grants to certain countries, importers (or importers/manufacturers) must comply with preferential rules of origin that are often very detailed and specific. Non-preferential rules of origin are equally important because they qualify goods for entry into the United States, and receipt of MFN tariff rates. In addition, non-preferential ROO assist CPB and other officials in the implementation and enforcement of key U.S. laws and policies, including government procurement laws, trade remedy actions, country of origin labeling requirements, and other provisions.

The ROO methodology employed in determining country of origin has become a matter of debate among economists and other trade policy experts for several reasons. First, the United States has entered into a number of bilateral and regional free trade agreements—each with its own preferential ROO scheme—which adds new complexities for importers and manufacturers desiring to benefit from these agreements, thus inserting economic inefficiencies into the international trading system. Second, since CBP has little legislative guidance in interpreting ROO, the agency often makes case-by-case country of origin determinations based on its own regulations and precedents. Some importers have criticized CBP because they believe that some origin determinations are subjective and/or inconsistent or may run

<sup>20</sup> (...continued)

Plea for a Reform of the WTO Regime on Rules of Origin,” *Journal of World Trade* (36) 2002, p. 171.

<sup>21</sup> Ibid.

<sup>22</sup> U.S. International Trade Commission. *Harmonized Tariff Schedule of the United States*. General Note 4 (19 U.S.C. § 1202).

contrary to congressional (legislative) intent. Third, in an international trading environment in which components of goods originate in many countries and assembly occurs in a completely different country, some observers suggest that one-country origin determinations may be misleading in some respects. Fourth, some express concern that current systems for determining country of origin may run counter to, or may be insufficient to enforce, other U.S. trade policies or trade objectives.

## Proliferation of Preferential ROO

The intent of preferential rules of origin is to ensure that goods from countries that qualify for duty-free or reduced rates of duty under a preference or FTA are able to receive these favorable tariff benefits, and that products from countries that are not parties to the agreement or preference are excluded.

**Concerns about Inefficiency.** Since preferential rules of origin are FTA-(or trade preference-) specific, assembling the proper documentation to ensure that products qualify for benefits under one of these programs can be a very complex and costly process. Some in the business community mention that the administrative costs associated with navigating the increasingly complex patchwork of regulations involved in establishing origin can outweigh the tariff benefits of FTAs.<sup>23</sup> Some economists also complain that the proliferation of FTAs between trading partners has led to an inefficient “spaghetti bowl” approach to trade policy—to a large degree because of rules of origin requirements.<sup>24</sup> The lack of transparency of preferential ROO is also a matter of concern for some. An often-repeated example of this is this is the so-called triple-transformation rule for apparel products within the NAFTA — meaning that the raw materials (fiber), the cloth, and the garment itself must all be processed within the FTA region in order to be NAFTA-eligible.<sup>25</sup> The triple transformation rule is not immediately discernable to the average person, nor are the costs of compliance.

However, others might argue that FTAs can still provide importers with greater flexibility in sourcing goods and more cost-effective means of entering the U.S. market. Importers always have the option of importing products under MFN (in which case non-preferential rules of origin would apply) status if they determine that this is the most cost-effective method of entry. Therefore, an FTA could be seen as providing importers and manufacturers with additional flexibility in choosing

<sup>23</sup> Ollilla, Jorma and Sutherland, Peter. “Business is Fearful as Doha Nears the Precipice,” *Financial Times*, April 23, 2006. See also, Ikenson, Daniel J. *Leading the Way: How U.S. Trade Policy Can Overcome Doha’s Failings*, Cato Institute, Trade Policy Analysis No. 33, June 19, 2006, p. 13, at [<http://www.freetrade.org/node/28>].

<sup>24</sup> Bhagwati, Jagdish and Krueger, Anne O. “U.S. Trade Policy: the Infatuation with Free Trade Agreements,” in *The Dangerous Drift to Preferential Trade Agreements*, AEI Press, 1995.

<sup>25</sup> Krueger, Anne O. “Are Preferential Trading Arrangements Trade-Liberalizing or Protectionist?,” *The Journal of Economic Perspectives* 13:4 (Autumn 1999), p. 112. Cadot, O. and de Melo, J. 2007. Why OECD Countries Should Reform Rules of Origin. Center for Economic Policy Research (CEPR) Discussion Paper (6172).

suppliers, as well as modes of entry (i.e., under preferential or non-preferential ROO). Importers can weigh the costs of compliance (combined with the more favorable FTA tariff rate) against importing goods from suppliers outside the FTA. For example, a study of rules of origin under the NAFTA illustrated that when the MFN tariff on a product is equal or more favorable than the NAFTA tariff, importers will typically choose to import under the MFN rate in order to avoid the additional compliance costs. However, when importers determine that the NAFTA rate (plus additional transaction costs) is more favorable, they choose to enter the goods under the NAFTA.<sup>26</sup> Importers may, in some cases, decide not to enter goods under an FTA, but the availability of such preferences gives them greater flexibility to purchase and import products in the most cost-effective manner available. The fact remains, however, that the utilization of trade preferences under preferential rules of origin is sometimes costly, and can inhibit the use of preferences in some cases.

In addition, from a trade policy perspective, preferential rules of origin are essential to reserve the benefits of an FTA for those countries who have entered into the agreement. Without preferential ROO, it would be possible for imports from non-FTA countries to enter the FTA partner with the lowest external tariff, and then serve the rest of the region under the FTA rate. This could force a convergence of external tariffs and possibly a competitive devaluation of external tariffs in the region.<sup>27</sup> Therefore, preferential ROO have a pivotal role in (1) reserving the benefits of the FTA for those countries who have entered into the agreement, and (2) ensuring that each FTA party can maintain a separate and independent external trade policy.<sup>28</sup>

The key challenges of constructing rules of origin in preferential trading relationships, therefore, are first, finding the balance between the effectiveness and the efficiency of ROO, and second, simplifying them and making them more transparent.

**Influence of Domestic Industries.** Some critics of rules of origin tests used in FTAs allege that because ROO are negotiated product by product and industry by industry, there is “enormous scope for well-organized industries to essentially insulate themselves from the effects of the FTA by devising suitable ROO,” thus diminishing its trade liberalizing effects overall.<sup>29</sup> As a result, more restrictive (and often more complex) ROO are often crafted to compensate domestic manufacturers that stand to lose protection as a result of an FTA or preference.<sup>30</sup> In addition, whole categories of goods may be completely restricted. However, others state that such measures are often successful in softening the opposition from import-competing groups, thus enhancing the political feasibility of subsequent FTA

<sup>26</sup> Kunimoto, Robert and Sawchuck, Gary. *NAFTA Rules of Origin*. Government of Canada. Policy Research Initiative Discussion Paper, June 2005, pp. 6-7.

<sup>27</sup> Ibid., p. 3.

<sup>28</sup> Ibid.

<sup>29</sup> Krisha, Kala. “Understanding Rules of Origin,” European Financial Management Association (EFMA) Meetings, Helsinki (2003), p. 1.

<sup>30</sup> Ibid.

implementation (after congressional approval).<sup>31</sup> Thus, many supporters of FTAs believe that the complexity of ROO for certain products may be a critical factor in garnering support for the FTA.

In addition, some studies indicate that more restrictive rules of origin, such as higher local content requirements, may also encourage producers of finished goods in an FTA region to shift from lower-cost suppliers of intermediate goods outside the FTA to higher-cost suppliers within the FTA region (often U.S. suppliers) in order to qualify for more favorable FTA tariff benefits. Thus, more restrictive ROO can be used to provide “protection” to these regional suppliers (as well as maintain existing protection against outsiders), to the extent that they provide sufficient incentive for FTA producers to buy more inputs inside the region.<sup>32</sup> Therefore, more restrictive local (or regional) content requirements can spread the benefits of the FTA to manufacturers of intermediate products in the region. This, in turn, can lead to additional support for an FTA within the domestic/regional manufacturing sector.

The following example illustrates the interest that the U.S. automobile sector demonstrated in influencing ROO during negotiations on the NAFTA:

All three [U.S.] automakers had an interest in a reasonably high rule of origin to make it more difficult for European and Japanese competitors to locate assembly plants in Canada or Mexico and thereby ship finished automobiles to the United States duty-free. But GM differed from Chrysler.... Because of [its] joint venture with Isuzu in Canada, GM favored a lower rule of origin, around 60 percent [regional content requirement]. For reasons that reflected their own patterns of production and competitive position, Ford and Chrysler preferred a higher rule, approximately 70 percent. Auto parts makers had every incentive to push for as high as a percentage as possible, since high percentages protected them from foreign competitors.<sup>33</sup>

## CBP Country of Origin Determinations

Country of origin rulings can be quite complex and lengthy, especially when questions on what processes or procedures are sufficient for a product to be “substantially transformed” come into play. Prior to importing a product, importers may also search the Customs Rulings Online Search System (CROSS) for a ruling on a product similar to theirs for guidance, or may request a binding ruling in advance of importation from the CBP Office of Regulations and Rulings.<sup>34</sup> A 2003 Government Accountability Office (GAO) report acknowledged that the CBP Office of Regulations and Rulings had improved its timeliness by issuing rulings within the

<sup>31</sup> Ibid.

<sup>32</sup> Chase, Kerry A. “Industry Lobbying and Rules of Origin in Free Trade Agreements,” International Studies Association 48th Annual Convention, Chicago, Illinois, February 28-March 3, 2007.

<sup>33</sup> Mayer, Frederick W. *Interpreting NAFTA: The Science and Art of Political Analysis*. New York: Columbia University Press, 1998, pp. 157-158.

<sup>34</sup> 19 C.F.R. 177.

Customs Commissioner's stated 90-day goal about 65% of the time.<sup>35</sup> One might argue, however, that for businesses trying to get products to market, even a 90-day waiting period might prove to be burdensome.

A major reason for this complexity is that, especially in situations involving non-preferential (MFN) origin rules, CBP officials often make these determinations on a “case-by-case” basis, using case law and prior CBP rulings and interpretations as precedent. CBP itself has admitted that even though these determinations are very fact-specific, a certain amount of subjectivity can be involved in CBP interpretations of these facts.<sup>36</sup>

**Proposed Changes.** In January 1991, CBP (then known as the U.S. Customs Service) began proposing more simplified and standardized rules for determining origin, when it put forward rules “intended to replace the present country of origin rules with more objective and transparent standards which will provide greater certainty and predictability for both the trade community and the Customs Service in making country of origin determinations required under existing laws and regulations.”<sup>37</sup> This proposal applied only to determinations involving goods that were wholly obtained or produced in a single country.<sup>38</sup>

On January 3, 1994, the Customs Service established interim regulations for “determining when the country of origin of a good is one of the parties of the North American Free Trade Agreement (NAFTA) in order to fulfill an obligation under Annex 311 of the NAFTA that provided that all parties should establish “marking rules” to determine when goods originate in a NAFTA country.<sup>39</sup> On the same date, the Customs Service published an additional notice that proposed amending its existing origin rules so that they would be more “objective and transparent and thereby to provide greater certainty and predictability for both the trade community and the Customs Service as required under existing laws and regulations.”<sup>40</sup> Customs acknowledged that application of the substantial transformation rule — as applied on a case-by-case basis when an article is not wholly the growth, product, or manufacture of one country — “often involves subjective judgements as to what constitutes a new and different article or as to whether processing has resulted in a new name, character and use.”<sup>41</sup> In particular, CBP suggested that the interim rules of origin used to implement the NAFTA commitment mentioned above, be applied to all merchandise imported into the United States — as an alternative to the

<sup>35</sup> Government Accountability Office (GAO). *U.S. Customs Service: Prospective Rulings More Timely, but Database Reliability Questions Remain*. GAO-03-828, August 2003.

<sup>36</sup> 59 F.R. 141. The subjectivity issue is more applicable to non-preferential rules because preferential ROO schemes provide more specific guidance.

<sup>37</sup> 56 F.R. 48448.

<sup>38</sup> Ibid.

<sup>39</sup> 59 F.R. 110, January 3, 1994. These rules were established in order to fulfill a

<sup>40</sup> Ibid.

<sup>41</sup> 59 F.R. 141, January 3, 1994..

substantial transformation rule.<sup>42</sup> This ROO scheme is also known as the “NAFTA Marking Rules” or “NAFTA annex 311 rules,” set down in CBP regulations under 19 CFR § 102. In addition to the aforementioned “wholly obtained” method, these rules include (1) a “tariff shift” methodology where country of origin is conferred to certain products in the place that they have undergone processing or manufacture sufficient enough to result in “an applicable change in tariff classification;”<sup>43</sup> (2) an “essential character” test, in which the country of origin is the “country or countries of origin of the single material that imparts the essential character to the good;”<sup>44</sup> and/or (3) a factory processing/assembly test.<sup>45</sup>

**Subsequent Hearing.** A hearing was held by the Trade Subcommittee of the House Committee on Ways and Means on the proposal in July 1995.<sup>46</sup> Testimony at the hearing indicated that — while all U.S. importers and manufacturers present favored an objective, fair, and transparent form of determining origin — many were concerned that using the NAFTA Marking Rules and the “tariff shift” method, as opposed to the concept of substantial transformation, would cause prohibitive regulatory compliance adjustment costs.

In addition, some domestic importers of intermediate goods, including the pharmaceutical, hand tools, coffee, electronics, food, and textile industries, indicated at the hearing and in prior conversations with Customs officials that they would be adversely affected by the measure.<sup>47</sup> The recently-begun harmonization effort on non-preferential rules in the WTO/WCO was also acknowledged, and some lawmakers recommended that Congress and the Customs Service wait for a resolution of these talks before changing the U.S. rules.

**Customs Decision.** On June 6, 1996, the Customs Service announced final implementation of the NAFTA Marking Rules proposed in the January 1994 notice, as amended, for purposes of goods imported from Canada or Mexico, but declined to apply them to imports from other countries (except for textiles and apparel).<sup>48</sup> However, the announcement left open the possibility that Customs might propose the application of these rules to all countries again at a later date.<sup>49</sup>

<sup>42</sup> Ibid.

<sup>43</sup> 19 C.F.R. § 102.11(a)(3).

<sup>44</sup> 19 C.F.R. § 102.11(b) and (c). If origin cannot be determined on that basis, an inventory management method may be used to determine origin.

<sup>45</sup> 19 C.F.R. § 102.11(d).

<sup>46</sup> U.S. Congress. House of Representatives. Committee on Ways and Means. Subcommittee on Trade. *Rules of Origin*. Hearing, 104<sup>th</sup> Congress, July 11, 1995. Serial 104-27. Comments of Chairman Crane, p. 4.

<sup>47</sup> Ibid. The NAFTA rules for textile and apparel articles had previously been applied for these goods from all countries (except Israel) in order to implement section 334(b) of the Uruguay Round Agreements Act (URAA), P.L. 103-465.

<sup>48</sup> 61 F.R. 2893, June 6, 1996.

<sup>49</sup> Ibid.

**2008 CBP Proposal.** On July 25, 2008, CBP proposed once again to expand the application of the regulations set forth in 19 C.F.R. part 102 (the “NAFTA Marking Rules”) to entries of goods under non-preferential rules of origin and “free trade agreements already negotiated that use the substantial transformation test to determine whether products qualify for reduced tariffs.”<sup>50</sup> CBP mentioned that the Part 102 rules had been implemented for all imports from Canada and Mexico, and nearly all textile and apparel products since 1996 (accounting for almost 40 percent of all U.S. imports) and, consequently, that the importing community and CBP have had extensive experience in applying these rules.<sup>51</sup> CBP noted that its experience implementing the rules had shown that “by virtue of their greater specificity and transparency, codified rules result in determinations that are more objective and predictable than under the case-by-case adjudication method.”<sup>52</sup>

In addition, CBP stated its belief that “the proposed extension of the Part 102 rules to all trade will result in determinations that are more objective, transparent, and predictable, and will therefore facilitate the exercise of reasonable care by importers with respect to their obligations regarding identification of the proper country of origin of imported merchandise.”<sup>53</sup> A public comment period on the proposed rule will end on September 23, 2008.<sup>54</sup>

## Global Manufacturing and Rules of Origin

Rapid advancements in science and technology since World War II have contributed to a major transformation of modern manufacturing. New manufacturing techniques have made it possible for less skilled workers to manufacture higher quality products with little waste or loss. In addition, the development of faster and more efficient communications and transportation technology has made it possible to reliably construct and ship components, parts and materials from multiple locations to the site of final assembly, making the manufacturing process more complex and intricate. As a result, an increasing variety of products incorporate parts and components from many different nations, often with the manufacture and assembly conducted in several different countries.

In addition to the increased competition among manufacturers, there has also been a restructuring of the overall manufacturing process toward subcontracting or “outsourcing” production. For many light consumer goods such as toys and electronics, major retailers or brand-name distributors traditionally considered “U.S. companies” have disengaged themselves from direct participation in the manufacturing of their products, relying instead on global trading companies to manage their product supply chains. Well-known retailers (such as Walmart, Sears,

<sup>50</sup> 73 F.R. 43385. The substantial transformation test is used in the United States - Bahrain and United States - Morocco free trade agreements.

<sup>51</sup> Ibid.

<sup>52</sup> Ibid.

<sup>53</sup> Ibid.

<sup>54</sup> Ibid.

and the Gap) and brand-name distributors of consumer products (such as Mattel, Nike, and Dell) utilize manufacturing companies in China and other countries to engage in the actual production and delivery of their products.

These characteristics of modern manufacturing have significant implications for international trade, including the following:

- The “nationality” of the product and the “nationality” of the manufacturer and/or initial owner are often different;
- Importers and/or initial owners may know very little about where or how a product was made;
- Frequently a relatively small percentage of the product’s total value was created in the attributed country of origin; and
- Globalized production can be simultaneously efficient and inefficient.

**The Case of the Apple iPod.** The manufacture of the Apple iPod provides a very clear case study of how electronics and other products are often produced in the global manufacturing environment. A recent study focusing on the iPod illustrated that the national home of the designer/importer of record, the components, and the ascribed country of origin of the product may indeed be very different. Researchers at the Personal Computing Industry Center of the Paul Merage School of Business at the University of California, Irvine, analyzed the value content of the production of a \$299 Apple iPod by dividing each step in the production process between gross margin and input costs.<sup>55</sup> According to their preliminary results, of the \$299 retail price:

- \$45 went to the retailer’s gross margin;<sup>56</sup>
- \$30 went to the distributors gross margin;
- \$80 went to Apple’s gross margin;
- \$144 went to the cost of the inputs of the iPod.

As to the \$144 cost of inputs, the researchers were able to further break down the cost of seven key component worth \$116 — including \$33 in gross margins and \$83 in input costs. The remaining \$28 in total input costs had not yet been analyzed, nor had the \$83 in inputs costs for the seven key components been fully analyzed.<sup>57</sup>

The iPod study also discovered that the typical iPod may contain parts and components manufactured in six different countries (China, Japan, Korea, Singapore, Taiwan, and the United States) by companies based in four different countries

<sup>55</sup> Linden, Greg, Kraemer, Kenneth L., and Dedrick, Jason “Who Captures Value in a Global Innovation System? The Case of Apple’s iPod,” Personal Computing Industry Center, The Paul Merage School of Business, University of California, Irvine, June 2007.

<sup>56</sup> A measure of corporate profitability defined as total revenue less the cost of the goods sold.

<sup>57</sup> Linden, et al. (2007).

(Japan, Korea, Taiwan, and the United States).<sup>58</sup> However, under U.S. country of origin procedures, the finished iPod was generally considered a product of China — the last place of substantial transformation.

**Effects on Rules of Origin.** As illustrated above, in the increasingly global manufacturing environment, the assembly point of the manufactured product and of its individual components are frequently different. These rapidly accelerating changes in the manufacturing process can lead to additional complexities in ROO determinations because officials must ascribe origin to a single country for import purposes.

In turn, these complexities can lead to apparent inconsistencies. For example, in some cases, CBP officials may decide that the assembly process (the value added by labor costs) is sufficient to confer origin, as it is the “last place of substantial transformation.”<sup>59</sup> In other cases, officials have determined that the final assembly process and labor costs incurred are actually not sufficient to confer this essential character.<sup>60</sup>

On the other hand, since CBP has the legal flexibility to be able to consider “the totality of the circumstances and makes such decisions on a case-by-case basis,” the agency is able to fully consider the extent and technical nature of the processing that occurs in each country, thus taking into account the “resources expended on product design and development, extent and nature of post-assembly inspection procedures, and worker skill required during the actual manufacturing process” when making country of origin determinations.<sup>61</sup> Therefore, the flexibility to analyze individual components and manufacturing processes could lead to more precise country of origin determinations, despite the complex nature of global manufacturing.

<sup>58</sup> Ibid.

<sup>59</sup> In Customs Ruling HQ HO127620, *Country of Origin of a Flashlight and Replacement Part*, CBP determined that a military-grade flashlight and a replacement part were of U.S. origin for purposes of the “Buy American Act” even though many of the parts were of foreign origin, including the lenses, circuit boards, lens reflectors, rubber gaskets, and plastic bodies. CBP found that the various imported components “lose their identities ... are substantially transformed as a result of the operations in the United States and become an integral part of a new article possessing a new name, character, and use.” In addition, CBP found that the assembly process and a light-emitting-diode (LED assembly) of U.S. origin represented a majority of the costs involved in making the product. See Customs Rulings Online Search System (CROSS), at [<http://rulings.cbp.gov>].

<sup>60</sup> In Customs Ruling HQ H021398 *Country of Origin of Ball Seals*, CBP determined that two types of ball seals made of five parts (three of U.S. origin and two sourced in China) that were shipped to China for a final assembly process were of U.S. origin for purposes of the “Buy American Act” because “the U.S.-origin components import the essential character to the assembled seals” and that “the Chinese operations are simple assembly operations that involve a small number of components and do not appear to require a considerable amount of time, skill, or attention to detail.” See Customs Rulings Online Search System (CROSS), at [<http://rulings.cbp.gov>].

<sup>61</sup> Ibid.

## Counter to U.S. Policy Objectives?

In the modern manufacturing environment, a U.S. (or multinational) company responsible for product design and manufacture may have very little knowledge about where and how imported goods are made, because the actual manufacture of the products has been subcontracted to a global manufacturing company that operates in many countries. While some major retailers and brand-name distributors have established social responsibility codes and employ vendor compliance officers to make sure that contracted factories comply with agreed codes of conduct, others rely on their global trading companies to ensure that their products are being made according to their corporate rules and procedures. While the origin of the product might be easily determined (i.e., as the last place of substantial transformation for MFN purposes), the possible lack of knowledge about intermediate steps in the manufacturing of the product can pose concerns for product safety and, in some cases, import security.

In addition, the global manufacturing market can be very responsive to changes in economic conditions such as the imposition of trade remedies and trade embargoes. Multinational manufacturers are increasingly able to shift the location of their operations in such a way that they are able to receive a country of origin determination that would avoid the additional duties payable in an antidumping case, or fend off any barriers to entry caused by a trade embargo.<sup>62</sup> This may be the reason that more trade remedy cases are brought forward on chemicals, raw materials, and intermediate goods rather than on finished manufactured goods or textiles and apparel.<sup>63</sup>

**Quotas.** An often-mentioned example of circumvention of U.S. quotas existed under the former World Trade Organization's Multifibre Agreement (MFA) and Agreement on Textiles and Clothing (ATC).<sup>64</sup> Under first the MFA and then the ATC, a number of WTO members — including the United States — placed quantity quotas on clothing imports from a number of countries. In the case of the United States, the trade policy objective was, in part, to protect the U.S. textile and apparel industry, and in part, to provide certain developing countries with access to the U.S. market which they would not otherwise have. However, when one country's quota was used up, clothing manufacturers, were often able to adjust the assembly of the apparel items being produced to obtain the desired country of origin determination

<sup>62</sup> The apparel industry has been engaged in offshore sourcing since the late 1950s in order to avoid quantitative limitations and additional duties on clothing exports. See Jin, Buyoungho "Apparel Industry in East Asian Newly Industrialized Countries: Competitive Advantage, Challenge, and Implications," *Journal of Fashion Marketing and Management*, 8:2, 2004, p. 230. Web-based supply chain technology, as well as access to more efficient transportation and other infrastructure needs, has enabled other manufacturing sectors to develop similar flexibilities.

<sup>63</sup> See the ITC website for a list of AD and CVD orders by product category, at [[http://www.usitc.gov/trade\\_remedy/731\\_ad\\_701\\_cvd/investigations/antidump\\_countervaling/index.htm](http://www.usitc.gov/trade_remedy/731_ad_701_cvd/investigations/antidump_countervaling/index.htm)].

<sup>64</sup> The WTO's MFA was in effect from 1974-1994; the WTO's ATC was in effect from 1995 to 2004.

— and thus, the necessary quota allowance — from U.S. customs officials. While the MFA and ATC are no longer in effect, quotas are important means of regulating imports of textiles and apparel entering under preferential rules (such as NAFTA), and of certain products claiming preferential treatment under programs such as the Generalized System of Preferences. Quotas are also sometimes used to protect import-competing U.S. manufacturers through trade remedy actions, such as import safeguards.

**Trade Embargoes.** The United States has long-standing trade embargoes barring international trade with countries such as Burma (Myanmar) and North Korea. Following the recent violent suppression of peaceful protests in Burma, legislation was introduced in both the House of Representatives and the Senate to further tighten economic and trade sanctions on the military junta in power.<sup>65</sup> These bills include language to block the import of products made using precious gemstones mined and lumber harvested in Burma. Such legislation was deemed necessary because the the Burmese Freedom and Democracy Act of 2003 (P.L. 108-61), which banned the direct importation of Burmese products into the United States, still allows Burmese raw materials such as gemstones and lumber to enter the United States provided that they are cut, polished or otherwise sufficiently transformed in a third country (such as India, China, or Thailand) so that origin is conferred to that country.

Another current issue dealing with enforcement of U.S. policy objectives is the treatment of goods and products manufactured in the Kaesong Industrial Complex (KIC) located in North Korea.<sup>66</sup> While the KIC is physically located in North Korea, many of its manufacturing operations are owned and run by South Korean companies. The South Korean government has asked the United States to treat the products made in the KIC by South Korean companies as South Korean products, even though current U.S. rules of origin laws and regulations would designate them as being products of North Korea. The United States currently has a trade embargo on products from North Korea, and the United States has never granted North Korea “normal trade relations” (NTR) status. Whether or not the United States agrees to this proposal, there is nothing to prevent South Korean firms from performing intermediate manufacturing operations in North Korea, and then performing final manufacturing processes (sufficient to confer origin) in South Korea.

**“Yarn Forward” Rule.** A third example of potential tension between the conferring of country of origin to products and other aspects of U.S. trade policy is the preferential origin rule included in the Dominican Republic-Central America-United States Free Trade Agreement (CAFTA-DR) for certain clothing

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<sup>65</sup> These include the Block Burmese Junta’s Anti-Democratic Efforts (JADE) Act, H.R. 3890, the Saffron Revolution Support Act of 2007, S. 2172, and the Burma Democracy Promotion Act of 2007, S. 2257. H.R. 3890, the Tom Lantos Block Burmese JADE (Junta’s Anti-Democratic Efforts) Act of 2008, was enacted on July 29, 2008 (P.L. 110-286).

<sup>66</sup> For a more complete analysis of this issue, see CRS Report RL34093, *The Kaesong North-South Korean Industrial Complex*, by Dick K. Nanto and Mark E. Manyin.

manufactured in CAFTA-DR nations.<sup>67</sup> Under the terms of CAFTA-DR, clothing manufactured in the region may be imported into the United States duty-free, provided that they are made of U.S. yarn and fabric under the so-called “yarn forward” rule. While this program is popular among U.S. textile manufacturers, there was concern during congressional consideration of CAFTA-DR that the “yarn forward” rule could be manipulated by non-CAFTA-DR nations to obtain duty-free access to the U.S. market. In addition, the existence of this program that provides indirect support for the U.S. textile industry has undermined U.S. criticisms of export subsidy programs of other nations.

**Food Imports.** Recent concerns about the safety of imported food have also revealed the potential for country of origin designation to pose problems for achieving desired trade objectives. Several bills have been introduced in Congress to bolster current federal laws governing the safety of imported foods, often with provisions allowing for an import prohibition on categories of food from a country if there is an established records of safety concerns for those goods.<sup>68</sup> While the intent of such provisions may be clear, the ability of manufacturers to shift key food processing operations to locations in other countries may reduce the effectiveness of some proposed import prohibitions.

**“Buy American”.** Another example of the possible effect of country of origin procedures on trade policies and objectives is illustrated by the “Buy American Act” [41 U.S.C. §§ 10a - 10d].<sup>69</sup> The act requires that the federal government procure manufactured products defined as being from the United States. A manufactured article is a U.S. product if it: (1) was manufactured in the United States; and (2) the cost of the U.S.-made components constitutes more than 50 percent of the overall cost of components.<sup>70</sup> Non-manufactured articles are considered U.S. products if they were mined or produced within the United States or “any place subject to the jurisdiction thereof.” While one of the stated goals of the “Buy American Act” is to protect U.S. workers, nothing in the act or current U.S. country of origin policies require that the products must be made and extracted by U.S. nationals.

<sup>67</sup> For more information on the provisions of CAFTA-DR, see CRS Report RL31870, *The Dominican Republic-Central America-United States Free Trade Agreement (CAFTA-DR)*, by J. F. Hornbeck.

<sup>68</sup> These bills include the Assured Food Safety Act of 2007, H.R. 2997, the Foreign Seafood Safety Act of 2007, H.R. 3077, the Import Safety Act of 2007, H.R. 3100, the Food and Drug Import Safety Act of 2007, H.R. 3610, the Consumer Food Safety Act of 2007, H.R. 3624, the Food Import Safety Act of 2007, H.R. 3937, the Imported Food Safety Improvement Act of 2007, H.R. 3967, and the Imported Food Security Act of 2007, S. 1776.

<sup>69</sup> For a summary of the “Buy American Act, see CRS Report 97-765, *The Buy American Act: Requiring Government Procurements to Come from Domestic Sources*, by John R. Luckey.

<sup>70</sup> Exceptions to the requirement to procure U.S. products are allowed in five cases: 1) it is deemed inconsistent with the public interest, 2) the cost is considered unreasonable, 3) the products are for use outside of the United States, 4) the products are not produced or manufactured in the United States in sufficient quantities or of satisfactory quality, and 5) the procurement is for less than \$2,500.

In the 1990s, there was a controversy over the U.S. government purchase of clothing manufactured in Saipan, the capital of the United States Commonwealth of the Northern Mariana Islands (CNMI), using mainland Chinese, Thai, Philippina and Bangladeshi workers in factories owned and operated by Chinese, Japanese and Korean subcontractors under allegedly “sweatshop conditions.”<sup>71</sup> Because articles of clothing manufactured in Saipan are legally U.S. products, they were able to qualify for U.S. government procurement, provided that over half of the cost of the product (including the value added by labor performed in the United States or a U.S. territory) came from U.S. sources.

## Conclusion and Options for Congress

Rules of origin are central components of trade policy. Preferential rules of origin are especially important for ensuring that only goods qualified to receive benefits under an FTA receive those benefits, and may also be constructed to ensure that import-competing U.S. producers are not adversely affected by the FTA, thus possibly assuring a degree of public support for the measure. Non-preferential rules are essential for making sure that goods coming from countries that enjoy MFN status with the United States are charged the proper tariffs, and are also key to supporting other U.S. trade laws, such as country of origin labeling.

At present, CBP makes country of origin determinations primarily based on an established body of regulatory and legal precedents. For many imports, determining origin is relatively straightforward. However, if the matter is in doubt, the origin question is decided on a case-by-case basis with input, records, and samples provided by the importer of record.

Although origin rulings are very fact-specific, there is sometimes uncertainty over what will be deemed as substantial transformation. Businesses sometimes criticize CBP and the current process as lacking clarity, consistency, and predictability.<sup>72</sup> Additionally, given the expanding use of preferential ROO as the United States potentially enters into additional FTAs, determining country of origin (or waiting for rulings from CBP) may prove to be a significant burden on importers, especially on smaller firms.

With regard to non-preferential rules, the United States has agreed to an ongoing Harmonization Work Program (HWP). Negotiations are ongoing under the auspices of the WTO Committee on Rules of Origin and the World Customs Organization. According to the USTR, however, reaching agreements on the technical aspects of the HWP have turned out to be more complex than initially envisioned, and negotiations are expected to continue through 2008.<sup>73</sup> Although these negotiations have lasted much longer than the originally specified three-year time period, progress

<sup>71</sup> Christensen, Jean “More Retailers Agree to Settle Saipan Garment Worker Lawsuits,” *Associated Press*, March 20, 2000.

<sup>72</sup> COO Marking Report, pp. 2-5.

<sup>73</sup> Ibid.; USTR Trade Policy Agenda.

has been made in resolving these differences. Congress could, through legislation or other means, encourage the administration to exercise leadership in this area with a view toward reaching a resolution to these negotiations. In fact, one of the principal negotiating objectives set forth in the Trade Act of 2002 was the conclusion of an agreement on rules of origin.<sup>74</sup>

The lack of transparency and apparent economic inefficiency of preferential rules of origin continue to be a matter of concern for some. However, as the USTR recently announced, the NAFTA partners implemented liberalizing changes to the NAFTA rules of origin (including certain apparel products) covering about \$15 billion in annual trilateral trade, and the NAFTA Free Trade Commission agreed in August 2007 on another set of liberalizing changes to the NAFTA rules of origin (covering over \$100 billion) to be implemented some time in 2008.<sup>75</sup> This illustrates that it is possible for preferential ROO to be simplified through mutual agreement of the parties even after an FTA is implemented. If Congress desires to provide greater preferential access to the U.S. market (and gain reciprocal access to the markets of trading partners), it could encourage further liberalizing preferential rules of origin, and could also encourage U.S. negotiators to develop a uniform set of preferential ROO (or a ROO template) to be applied in future FTA negotiations.

Since the processes of globalization described above are likely to continue making origin determinations even more complex, Congress might also consider providing CBP with additional legislative guidance, especially in the area of non-preferential rules. However, such efforts may adversely affect importers and manufacturers who benefit from the current system. In addition, even though the determination process may be complex and lengthy, CBP now has the flexibility to examine the complete manufacturing process, including design, sources of intermediate components, labor costs, and assembly processes in order to make its country of origin determination.

Some trade policy analysts have called for the liberalization or abolition of preferential rules of origin. Others advocate the abolition of rules of origin entirely, because they inject a large amount of inefficiency in the world trading system, and because they can effectively serve as a form of protection for import-competing industries. This approach might be the simplest way of counteracting the negative effects of preferential ROO, for example, by excluding sensitive products from trade preference schemes.<sup>76</sup> Some observers argue for the multilateral elimination of tariffs, which, they say, would eliminate the need for ROO entirely.<sup>77</sup> However, the end of tariffs would automatically lead to the end of all preference programs and the benefits of FTAs as well, because the gains that accrue to these trading relationships are largely based on receipt of more favorable tariffs (or duty-free access of goods).

<sup>74</sup> P.L. 107-210, sec. 2102 (13).

<sup>75</sup> USTR Trade Policy Agenda, p. 119.

<sup>76</sup> Estevadeoral, Antoni and Suominen, Kati. "Rules of Origin: A World Map and Trade Effects." Paper delivered at conference on *Rules of Origin in Regional Trade Agreements: Conceptual and Empirical Approaches*. February 2004.

<sup>77</sup> Ibid.

In addition, eliminating rules of origin entirely could pose issues for other trade policy objectives such as country of origin labeling, implementing trade sanctions, enforcing trade remedies, and other trade policy objectives.